



OXFORD ANALYTICA

ISRAEL

FISCAL TRANSPARENCY

Country Report 2005

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ISRAEL



COMPLIANCE RATINGS

<i>Fiscal transparency</i>	2005	2004	2003	2002
Clarity of roles
Availability of information
Budget preparation
Accountability
Score	3.25	3.25	3.25	3.25

OUTLOOK & COMMENTARY

Israel has made a number of improvements towards increasing fiscal transparency this year. An amendment was made to the Reduction of Deficit Law limiting the growth of public expenditure to 1% per annum in 2005-2010 and the budget deficit to 3% of GDP. These goals are included in the Macroeconomic Framework, the horizons of which now reach as far as 2010.

Six ministries have adopted accrual accounting so far and more will follow next year. Accrual-based accounting will be government-wide by the end of 2007. Privatisation has moved forward this year, but its continuation in the coming year will depend on the economic policies adopted by the next government, elections for which will not be held until March 2006. The preparation and release of the next budget will also be delayed until after the elections.

The main area requiring further improvement is the budget, which lacks sufficient explanatory notes to accompany the data and so is somewhat opaque.

EXECUTIVE SUMMARY

3.25 Enacted

Israel has made a number of improvements towards greater transparency in fiscal operations over the last year. The Reduction of the Deficit Law was amended this year to limit the growth of public expenditure to 1% per annum in 2005-2010 and limit the budget deficit to 3% of GDP. However, its application lacks transparency and the expenditure limit in particular faces constant pressure from politicians. The macroeconomic framework for the budget now projects as far as 2010 and has a clear, transparent set of medium- and long-term budgetary goals.

The privatisation of public enterprises has picked up pace in the last year. El Al, Bezeq and Zim, the Israeli shipping company have recently been privatised. The immediate agenda includes the privatisation of Discount Bank, Israel Aircraft Industries, Israel Military Industries, and Israel Oil Refineries. There are also proposals for increasing competition among the airlines, and reform of the Israel Electric Corporation. This year, transparency of the public sector has improved with the release of more information from companies in the process of privatisation. However, given the current political situation, it is not clear to what extent privatisation will be pushed forward in the coming year by the newly elected government and it will almost certainly be delayed until after the general election in March 2006.

In 2003, the government began moving to accrual-based accounting using a specially designed software platform. Six ministries produced statements on an accrual basis last year, and 13 to 15 ministries will have adopted accrual-based accounting by the end of 2005. The budget continues to be compiled on a cash basis, but the MoF anticipates that by the end of 2006, 80% of the budget will be accrual based. Accrual-based accounting will be government-wide by the end of 2007. The use of the software platform will enhance the accountability of finances and help to link ministries together.

In 2004, the government began the process of adopting the International Federation of Accountants (IFAC) Handbook of International Public Sector Accounting Standards. It hopes to adopt at least half of the 21 standards in 2006, and the remainder by 2007. As part of the accounting reform the first new financial statement was published in September 2004. Improvements are ongoing; next year, there are plans to reform and combine the budget execution report with the financial statement, include more information on government assets, and reduce the time lag in publication from six months to three.

The main area still requiring improvements in transparency is the budget; the change in the political situation will undoubtedly mean a delay in the preparation and release of the 2006 budget. There is also a tendency to publish budget data without complete explanations of what the numbers mean, and the complexity and lack of clarity of the budget make it difficult to judge whether stated policies are being carried out in practice. Neither is there adequate analysis of fiscal vulnerabilities. On a general level, there is still a lack of information translated into English, although this is improving to some degree.

Israel's overall score is unchanged from last year.

1. CLARITY OF ROLES, RESPONSIBILITIES AND OBJECTIVES



Enacted

The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.

Structure, functions and responsibilities of government

Israel's Basic Laws, which have constitutional status, set out the structure, functions and responsibilities of the government. Under these laws, the general government consists of the government ministries, local authorities, non-profit institutions (including universities, secondary schools, sick funds, community centres, museums, research institutes, and similar entities) and the National Insurance Institute.

The budgetary department of the Ministry of Finance (MoF) is responsible for public expenditure, the coordination of the budget-planning system and multi-annual planning. The Department of the Accountant General (DAG) is responsible for budget implementation, control of state liabilities, establishing financial and economic procedures, and managing the government accounts.¹

Coordination and management of budgetary activities

Responsibilities between the different levels of government are clearly allocated in law. The coordination and management of budgetary activities are centralised within the MoF, and this year management of the government's domestic loans has also shifted from the Bank of Israel to the MoF.² The Basic Law of the Government does not, however, allocate a division of expenditure programme responsibilities between the central government and local authorities. Israel is a centralised state, and over the years, the MoF has developed a strong technical capacity and expertise concerning budgetary activities. This has made it difficult for external analysts to review the budgetary figures that the MoF produces. For example, in 2002, although the MoF's revenue and spending projections came under heavy criticism, no other organisation had the broad range of expertise or technical capacity to challenge the MoF's assumptions. The result was that, within a few months following passage of the budget, two supplementary budgets had to be introduced. The MoF is aware of this problem and has started to amend matters, but no changes have been put in place as yet.

The DAG of the MoF is responsible for ensuring the compliance of budget execution with appropriations.

Mechanisms for the coordination of extra-budgetary funds and activities within the budget are well defined.³ An ongoing source of concern to analysts is the government's propensity, in all proposed budgets, to leave large funds under the section labelled 'reserves'. The purpose of this section is twofold: to deal with unanticipated crises and to fund the secret services. The secret services almost automatically take around two-thirds of the funds allotted. The remainder is allegedly used for security alerts and other unforeseen activities. However, the 'free' reserve money has usually been used more prosaically to cover sudden increases in spending as a result of political deals in the Knesset (Israel's legislature), or to cover mistakes made by the MoF in overly optimistic projections. It is not unusual for the reserve fund to be carved up between sectoral interest groups at the beginning of the fiscal year, and for the fund to run out of cash well before the fiscal year is over. Contingency reserves remain hidden in other budget categories.

The reaction of the MoF has been to create a series of false projected expenditures in each budget that can then be used for real contingencies. All the data projections are open and available -- thus satisfying regulations on transparency. However, since the budget averages about 10,000 line items, the figures are rarely checked by oversight committees.⁴

However, not all the inaccurate forecasting of revenues is the fault of the MoF. The government as a whole plays a critical role. Over the previous two years, funds from the privatisation of government companies crawled almost to a halt -- largely as the result of lobbyists' pressures. Although big reforms were planned for 2006 by the now-fractured coalition government, any progress will now almost certainly be delayed until after the general election in March 2006.⁵

Another important source of revenue has been the Israel Lands Authority (ILA). Responsibility for it has passed through no fewer than four ministries. Although the regulations guiding the ILA's activities are publicly available, the criteria used by the ILA's land assessors have never been clearly laid out. There has been talk of reform in recent months, but again, it is not clear what priority this will take now, given the unstable political situation.

The MoF has cooperated with the Bank of Israel (BoI) in providing data to the BoI for its project to assess the medium-term implications of all fiscal legislation. Budget forecasting has improved. The BoI created a multi-year budget, based on budget trends and actual legislation, and published it for the first time in the 2002 *Annual Report*. It has been updated each year since, to reflect the passage of new measures. The BoI's multi-year budget study is a 70-page report listing each separate budgetary component and each assumption that goes into it. Beginning with the September 2003 MoF *Outlook* publication, available on the Internet, the MoF is publishing the medium-term budget forecasts and risks analyses, incorporating prices, labour markets and other real variables.

When governments are weak, there has been a strong tendency for small factions to introduce and negotiate the passage of new and expensive spending bills even after the budget has been passed. Knesset members are subject to intense pressure by small and often publicly invisible lobby groups. For example, this has meant that serious distortions have crept into the taxation and regulatory system. This, in turn, leaves economic analysts with a lack of clarity for months on end as to how the tax and spending systems will work in the forthcoming year. Two attempts within the last few years to reform the system have failed precisely because the lobbying system was so strong.

However, a new research section in the Knesset has meant that Knesset members can seek expert research and advice on fiscal matters, something that is increasingly used.⁶ Also any Knesset member's private bill that will require the expenditure of more than five million shekels must have the support of 55 members from the 120-member house. This provision will be renewed as part of the Economic Policy Law, which is the enabling legislation that accompanies every budget.

Relations between government and public sector agencies

Government activities are clearly distinguished from those of public financial institutions and non-financial public corporations (NFPCs). The NFPC sector is large.⁷ The BoI law places special emphasis on the independence of the central bank. Fiscal policy is exclusively the responsibility of the government. The BoI's services to the government include making and receiving payments and handling some of its financial activities abroad.⁸ The management of the government's domestic loans, previously a task of the BoI, is now with the debt management unit at the Treasury.⁹ The amounts of credits, advances or overdrafts to the government can be found in the monthly balance sheets of the BoI.¹⁰

As part of the structural and fiscal reforms in the past two years, there has been a major overhaul of the country's union-run pension funds. Israel's biggest pension funds have been taken out of the management and care of the

Histadrut (General Federation of Labour) and two more pension funds, belonging to the banks, have already been sold.¹¹

A recent IMF Report on the Observance of Standards and Codes (ROSC) recommended the clarification of the relationship between insurance and pension supervision and other financial agencies.¹²

Government involvement in the private sector

The government still owns or is the majority shareholder of some large companies in Israel, (such as Israel Aircraft Industries, Discount Bank and Mekorot), but in the last year it has instigated a privatisation drive. The government companies report quarterly and annually to the Government Companies Authority which publishes an abstract of the accounts in its *Annual Report* to the public. Bezeq, Israel Oil Refineries and Bank Leumi now publish quarterly financial reports as they are publicly traded on the Tel Aviv Stock Exchange.¹³

The government does not privatise when it would lead to a monopoly. On the whole, privatisation is carried out in a transparent manner, and the legal basis for privatisation is detailed in the Government Companies Law. Government regulation of utilities and the private sector is largely transparent.¹⁴ However, as part of the structural and fiscal reforms, the privatisation of public enterprises has picked up pace. El Al, Bezeq and Zim, the Israeli shipping company have recently been privatised. The immediate agenda includes the privatisation of the Discount Bank, Israel Aircraft Industries, Israel Military Industries (IMI) and Israel Oil Refineries.¹⁵ There are also proposals for increasing competition among the airlines, and reform of the Israel Electric Corporation (IEC), by splitting the company into three separate companies, based on activity. However, there is opposition from the unions (something which remains a problem in general) and the Ministry of Infrastructure, which has delayed proceedings. After structural reform of IEC, the next step would be to privatise, but this would take several years.¹⁶

One of the tasks of the Government Companies Authority (GCA) is to publish an annual report on government companies. The report contains financial statements for government companies, the percentage of government equity holdings in these companies and the amounts of revenues generated by them for the state. This year, transparency has also improved with the release of more information from companies in the process of privatisation.

There should be a clear legal and administrative framework for fiscal management

Legal framework for budgetary activities

The Basic Law on the State Economy sets out general budgetary procedures and establishes the government's authority to pass an Interim Budget Bill when the budget has not been adopted by the legislature before the start of the fiscal year. This Interim Bill allows the government to spend one twelfth of the previous year's budget on a monthly basis for three months. If the budget fails to pass at a third reading, new elections must be held within 90 days.¹⁷ The provision for an Interim Bill was employed in 2002 when the Knesset was unable to pass a budget bill by the beginning of the fiscal year. In 2004 and 2005 there were also delays in the budget, but the Interim Bill was not employed. Instead, a 'continuing budget' was employed taking figures from the old or new budget -- whichever is smaller. Given the political upheaval this November, similar measures will also need to be adopted for this year's budget since the new budget will not be presented until after the elections in March 2006. The Basic Law allows as much as three months for the budget to be presented (21-42 days to form a coalition if necessary, and 45 days to prepare a new budget).¹⁸

The MoF's Budget Department administers public expenditure and coordinates and facilitates the entire government and public budget-planning system.¹⁹ Procedures concerning the expenditure of public funds are set out as part of the Basic Law on the State Economy and the Basic Law on Government.²⁰

Both law and precedent guide the preparation of the budget. In normal years, it is submitted to the cabinet in July. Usually two or three cabinet debates are devoted to this purpose. However, even in the best of years, since ministers are invariably preoccupied with the implications of the budget for their own ministries, there is scant time for a full-scale macroeconomic debate because the massive document must be submitted to the Knesset by the end of October.

Legal framework for taxation

Taxation has a clear basis in law. All laws, tax ordinances and regulations are openly available and gazetted in Reshumot (the state gazette). Information on taxes is comprehensive and can be found on the government gateway website and is also provided by the State Revenue Administration.²¹ The tax system is not unduly complicated.²²

A 2002 abbreviated tax reform bill raised the value-added tax (VAT), and increased social insurance payments, but also taxed certain types of capital gains for the first time and altered the tax framework under which the labour market operates. Implementation of these changes has continued, with additional changes implemented in the last two years. Tax reforms are bearing fruit, as the MoF has seen revenues coming from capital gains and other areas of recent tax reform. There have been improvements in income tax regulations. All regulations are now published on the MoF website.

In July of this year, the Knesset approved the tax reform proposals of former finance minister Benjamin Netanyahu for reductions in VAT, corporate income tax and the highest margin of individual income tax among other items which will be implemented over the next five years. Besides a press release, there is no other information on the reforms available on the MoF website.²³

One of the main complaints is the length of time it takes to resolve tax disputes. This does not look likely to improve in the near future.²⁴

Ethical standards for public servants

The Civil Service Code sets out ethical standards of behaviour for public servants. The code is only available in Hebrew.

2. PUBLIC AVAILABILITY OF INFORMATION



Enacted

The public should be provided with full information on the past, current, and projected fiscal activity of government.

Comprehensive information is available online, though there is a need for more laws and relevant information to be available in English.

Central government operations

The budget documents are comprehensive -- though not detailed -- and cover most fiscal activity by the government. Extra-budgetary data on pensions, the National Insurance Institute, and other government enterprises are included in the Budget Proposal document. Estimates of central government tax expenditures are included in the budget documentation. Information on financial assets and on gross and net public debt is published. Detailed information on government equity holdings in public and private enterprises and financial statements of privatisation operations is included in the annual report of the Government Companies Authority. The Central Bureau of Statistics (CBS) publishes quarterly and annual information on the level, maturity and currency composition of gross central government debt, in line with the IMF Special Data Dissemination Standard (SDDS).²⁵ Commentators have noted, however, that there is a habit of publishing data without complete explanations of what the figures mean, and also that the complexity and lack of clarity in the budget makes it difficult to judge whether stated policies were being carried out in practice.²⁶

The CBS publishes quarterly national accounts including data on general government current expenditure.²⁷ Some CBS data are being harmonised to comply with Eurostat protocols.²⁸ In 2003, the CBS began adapting Eurostat classification of goods, and provided re-classified data to Eurostat dating from 1996. This process is still continuing. The CBS also prepares quarterly data on fixed capital formation by the general government.

The Budget Proposal document includes comparative figures on the previous year's budget, realised figures for the year before that, alongside expenditure allocations for the prospective year. Each ministry's 'blue book' budget document compares the previous year's actual expenditure with the current and next year's budgeted expenditures. It does so on a net and gross basis, where net separates out the expenditures not linked to (contingent upon) revenues. There are few projections or assessments in the budget document for the impact of items passed by laws and government decisions, even for the year immediately following the budget year. There is now a draft budget structure included in the Macroeconomic Framework up until 2010, but this document is not published. The Tax Reform Law, which could contribute to large new deficits in forthcoming years, also lacks revenue projections.

Regular publication of data on the execution of the budget is required by law, and a calendar of release dates is announced.²⁹

Revenue projections have been highly inaccurate in the past five years. Previously, revenue projections were overly optimistic, in order to make room for more spending without breaching deficit limits. Since 2003, revenue projections have been overly conservative in an effort to curb the excessive spending seen in previous years. The government has also introduced an amendment to the Deficit Reduction Law establishing ceilings for government expenditure for 2005-2010. This should also help reduce overly optimistic revenue projections.³⁰ Commentators

expressed concern that there was no comparative source for data for revenue projections.³¹ The *Annual Report* explains the difference between forecasts and outcomes. In the past there were some differences in the estimation of GDP between the MoF and the central bank. They use separate models, but estimates are now becoming more similar.³²

Commentators judged the defence budget to be the least transparent of all budget items as it is separate from the main budget. Therefore, if the defence ministry wishes to alter its budget, it can do so immediately, only having to obtain de facto authorisation from the MoF and the Knesset Finance Committee. The only existing limiting provision on defence spending is an order from the MoF stipulating that if the defence ministry wishes to increase spending by more than 90 million Israeli shekels (approximately 19 million US dollars), it must ask in advance. The defence budget is also not publicly available -- only the broad defence budget framework is published -- although there is a tentative plan to make it available to Knesset members.³³

The Foundations of the Budget Law (FBL) mandates that the MoF update budgetary estimates by incorporating the in-year adjustments approved by the Knesset. The FBL also mandates that the MoF submit a quarterly report on the deficit and its financing to the Knesset. The Department of the Accountant General produces both monthly and quarterly reports, which include estimates of the deficit and its financing, as well as information on the execution of revenues and expenditures of the central government (although the classification system used deviates from international standards).³⁴ However, a complete update of the budgetary estimates of revenues and expenditure is only carried out annually in the budget execution report, a document that is published in January.³⁵

Israel complies with the System of National Accounts (SNA) of the IMF Government Finance Statistics Manual, although the IMF has specified that the GFS statistics should be published separately from the National Accounts and with explanations, something that the Central Bureau of Statistics is working to comply with.³⁶ The Accountant General is responsible for reporting actual annual expenditures. The report is considered to be credible, but it is released with a lag of six months. Efforts are being made to reduce this to three months.

The MoF in 2003 added Internet-based services for taxpayers, such as the online payment of VAT and fines, and 'know your rights' information for new citizens. Translation of MoF information into English remains an area of weakness. There is a view that the private sector is already providing this service to the investment community.

Israel publishes comprehensive quantitative information on most of the central government's contingent liabilities.³⁷

Public sector operations

A number of quasi-governmental organisations, such as the Jewish Agency, Keren Kayemet L'Ysrael (KKL) and Keren Hayesod, perform some quasi-fiscal activities, usually in bringing in new Jewish immigrants. The government and private donors fund these agencies. For a more complete understanding of their functions and sources of revenue it is necessary to consult the annual report each is required to publish. None of these agencies have to follow the same disciplinary measures as the main line ministries.

A commitment should be made to the timely publication of fiscal information.

Israel is a subscriber to the IMF SDDS for economic and financial statistics and meets its specifications for the coverage, periodicity and timeliness of the data.³⁸

Chapter three of the State Comptroller Law requires the government to publish fiscal data. Further, Article 49c of the FBL states that a quarterly performance estimate of the deficit and its financing must be released at the end of each quarter and submitted to the Knesset Finance Committee.

Debt Reporting

The Budget Proposal document and the government's *Annual Financial Report* contain comprehensive information on government debt and financial assets. Data on central government debt are publicly disclosed quarterly, three months after the end of the reference quarter in the relevant issue of the CBS monthly *Selected Economic Indicators*.³⁹ The Bank of Israel provides annual estimates of the gross and net general government debt with its level and composition, by sub-sectors.⁴⁰

Advance release calendars

In accordance with its commitment to the SDDS, Israel produces advance release calendars across the range of fiscal data that it releases under the provisions of the SDDS.

3. OPEN BUDGET PREPARATION, EXECUTION AND REPORTING



Enacted

According to the most recent IMF fiscal transparency ROSC, the area requiring most improvement is the way in which the budget is prepared and presented. The IMF recommended that the budget documents include a more systematic analysis of the sensitivity of the budget to economic and financial shocks, and additional information on budget execution (including a revised projection for the year in course). Furthermore, the IMF recommended that the expenditure classification should be revised to conform more closely with international standards. The IMF also notes that the general government deficit is not an especially useful fiscal indicator.⁴¹

Fiscal policy objectives, macroeconomic framework and risks

Fiscal policy objectives

Fiscal policy objectives, the macroeconomic framework and the policy basis for the budget are set out and analysed in both the final budget document and in the Budget Proposal document. However, the information on fiscal objectives is relatively general. As noted by the IMF, the Annual Budget Law “includes broad functional, economic and program classifications that are considerably less detailed than those set out in the IMF’s *Government Financial Statistics Manual 2001 (GFS 2001)*”.⁴²

The government sets a deficit target, which is prescribed by the 1993 Reduction of the Deficit Law. It was hoped that the law would divert some part of the stronger revenues toward reducing the national debt, rather than letting politicians spend the new revenues.⁴³ However, this law has been breached in each of the subsequent years since its passage owing to the ongoing recession and the subsequent shortfalls in tax revenues; and the sectoral interests for additional transfer payments. In fact, according to officials, the law requires that the budget must be planned with the deficit target in mind, but there is no legal requirement to meet the target.⁴⁴ As the Reduction of the Deficit Law is binding only at the planning stage, not at the expenditure stage, the MoF recognised that it was not working, and it was amended this year. The amendment limits the growth of public expenditure to 1% per annum in 2005-2010 and limits the budget deficit to 3% of GDP. However, its application lacks transparency, and the expenditure limit in particular faces constant pressure from politicians.⁴⁵

In 2003, confronted by the worst and longest economic recession in Israel's history, the government adopted one of the largest-ever economic reform packages. It contained a number of structural and fiscal reforms that the MoF had tried to persuade politicians to take up for years. The economy has now entered a modest recovery path. The last coalition government, which dissolved in November 2005, was far more homogeneous on core economic issues than the previous one, thus facilitating reform. The structure of the economy is being substantially overhauled. Structural and fiscal economic reform plans include abolishing special tax breaks for rural areas, merging some local councils, reducing payments to local authorities and increasing municipal taxes. In addition, a major overhaul of the country's union-run pension funds was planned, as well as increased privatisation. The previous Finance Minister, Binyamin Netanyahu, had begun to work towards liberalising the economy. However, it is not clear whether this policy stance will be continued as much depends on the results of the next year's elections.⁴⁶

Macroeconomic framework

The macroeconomic framework has a clear, transparent set of goals, and includes medium- and long-term budgetary goals, such as the expenditure and deficit limits. It is set out in the Major Provisions of the Budget section of the Budget Proposal and now projects as far as 2010. The same section sets out the targets for the coming fiscal year and outlines government policy for major economic and social sectors. The Composition of the Budget section is intended to provide a comprehensive explanation of current expenditure and how it will be used in different economic sectors. However, this section cannot be relied upon as a definitive predictor of government activity. Each year, mid-term, funds are invariably transferred from one sector to another to cope with stopgap needs.

The Budget Framework section of the Budget Proposal contains an explanation of the government's tax policy and its effects on the Israeli economy. Since budget reporting is based almost entirely on cash flow, as the fiscal year draws to a close many payments to suppliers are held up and carried over to the accounts of the following year. In 2002 for example, the government chose not to issue VAT refunds as scheduled on 20 December, but to hold them over until January 2003.

Fiscal risks

The Accountant General has set up a subsidiary office to study liability management. The office has been formed under the debt management unit. The unit is building a model to analyse fiscal risks and other macroeconomic risks. The date of implementation is uncertain.⁴⁷ Up to now, public debate on the issue tends to focus almost solely on the assessments made by the world's three largest analysts of sovereign debt (Moody's, Standard and Poors, and Fitch).

MoF has been publishing analysis of fiscal and macroeconomic risks in its *Outlook* publication since 2003.

Fiscal sustainability

Within the Treasury, there are no fiscal sustainability assessments, such as debt management sensitivity checks or analysis of the sensitivity of the budget estimates to changes in economic or financial conditions. The main fiscal vulnerabilities are not discussed in the budget documents. However, the Department of the Accountant General has established a debt management office, which conducts research on fiscal vulnerability.⁴⁸

The Bank of Israel also conducts periodic analyses of fiscal sustainability and its sensitivity to macroeconomic developments. The fiscal sustainability analysis must be published twice a year in the BoI *Annual Report Research* close to the time of the budget submission to the Knesset in late October or early November. The budget submission is published in BoI periodic publications or in a special press release.⁴⁹

Budget presentation

The complete budget is only published in Hebrew. Net expenditure and revenue-contingent expenditure constitute the gross budget. The National Budget specifies amounts as net expenditure, gross expenditure and revenue-contingent expenditure. Budget items of each expenditure type are also detailed. The Treasury publishes a 'blue book' for each ministry, commenting on its performance. It is moving towards reporting quantified physical results of expenditure, such as number of kilometres of roads built. A move to performance-based budgeting would improve transparency and aid parliamentary scrutiny of the budget process, but there are obstacles to measuring productivity in some ministries which would need to be overcome if this were to be implemented across the board. The MoF recognises that it will take years to implement performance-based budgeting.⁵⁰

The auditing department of the Ministry of Interior, the State Comptroller and the MoF's director in charge of salaries monitor the local authorities. A special accountant can restrict funding to the local authorities from the central budget. The financial reports of each authority set out the amount of budgetary transfers from the government.⁵¹ The specific proposed and past allocations for the local authorities are not disclosed in the budget. The Budget Proposal document presents the consolidated fiscal position of the general government.

The *National Budget*, includes forecasts for the two years following the budget year. Until 2002 the *National Budget* was published jointly by the BoI and MoF, but this was not the case in 2003 owing to disputes between the BoI and the MoF. This has remained the case, but the ending of joint publication is not seen as a concern either by BoI or MoF officials. In fact, officials felt this system was better, in that in the past the reports were weaker because officials had to negotiate figures, policy, and wording; now each report has clear analysis and projections.⁵² This year, only the MoF has published the *National Budget* for 2006.⁵³

The budget documents detail the government's major policy objectives but do not always report progress in achieving them. However, the explanatory report and the blue books usually report on progress.⁵⁴

From October 2003, the 'yellow notes' publication, an explanatory guide to the budget presented to the legislature is being published on the MoF website. It includes several macroeconomic analyses. The government has started to present details on any missing or inconsistent data and any discrepancies in the yellow notes at the end of each section in the final budget.⁵⁵

Commentators stated that the budget process is transparent, if not necessarily the budget itself.⁵⁶

Budget execution and monitoring

The Internal Audit Unit audits all ministry units with the assistance of internal departmental audit units. It also monitors the correction of irregularities found in the internal audits and in audits by the State Comptroller. The unit presents its reports to the Director General of the MoF and the directors of the audited units.

Efforts are underway to improve the accountability of local authorities' spending. The government has become stricter in its loans to municipalities and has set up 'recovery plans', which has led to a reduction of deficits among weaker municipalities. Spending is only increased if the recovery plan is adopted.⁵⁷ Additionally, when a local authority is not managing its budget in a satisfactory way, the Ministry of the Interior appoints an 'accompanied accountant' (that is, an accountant who accompanies the local treasurer) whose signature is required for any financial commitment or expenditure of the local authority.⁵⁸

In a recent ROSC, the IMF recommended that budget documents should include some additional information on budget execution, including a revised projection for the current year, and information on general government and the financial statements of the larger government companies. The IMF recommends that the FBL be amended to provide a legal basis for this increased information.⁵⁹

As of this year, ministries are allowed to spend on a monthly basis; previously, they were given an annual budget, but often ran out of funds by the end of the year. They now receive a monthly permitted budget from the MoF, which is adjusted quarterly if needed. As of November this year, ministries are also allowed to see their own budgets for the next year, which will undoubtedly improve their ability to plan.⁶⁰

Accounting basis

The central government accounting system produces timely and accurate data.⁶¹ Israel's central government transactions are recorded on a cash basis, besides foreign grants data, which are partly recorded on an accrual basis. In 2004, the government began the process of adopting the International Federation of Accountants (IFAC) Handbook of International Public Sector Accounting Standards. A board has been created for this operation, and they are currently translating the standards. They hope to adopt at least half of the 21 standards in 2006, and the remainder by 2007.⁶² The Accountant General Department's integrated fiscal management system (FMIS) produces a complete and aggregated monthly report on central government activities published on the first day of every month.

In 2003, the government began moving to accrual-based accounting. The MoF began 'beta testing' an Economics Resources Planning (ERP) software platform, which will allow partial accrual accounting. The current balance sheet includes many details missing previously, thanks to the gradual introduction of accrual-based accounting. Liabilities are now covered in full and assets are being covered in part; for example infrastructure, investments and army assets are now included. Six ministries produced statements on an accrual basis last year, and by the end of 2005, 13 to 15 ministries will have adopted accrual-based accounting. The budget continues to be compiled on a cash basis, but the MoF anticipates that by the end of 2006, 80% of the budget will be compiled on an accrual basis. Accrual-based accounting will be government-wide by the end of 2007. The use of the ERP platform will enhance the accountability of finances and will help to link ministries together.⁶³

Government pensions are currently not included in measures of the public debt, but the adoption of accrual accounting could see this happen. This would dramatically increase public debt, perhaps taking it as high as 200% of GDP.⁶⁴

As part of the accounting reform the first new financial statement was published in September 2004. The report -- which also includes an auditing critique -- is available online, but only in Hebrew. Improvements are ongoing; for example, this year's report fully explains committed expenditures. Next year, there are plans to reform and combine the budget execution report with the financial statement, include more information on government assets and provide separate information on all projects (often settlement projects) worth over 100 million Israeli shekels (22 million US dollars). The DAG also intends to reduce the time lag in publication from six months to three.

A significant change in accounting practices in 2002 was the decision to introduce the definition of 'government deficit' for government bonds. However, the process is expected to take around ten years, until indexed-linked debt is finally retired.

Procurement and employment

The IMF judges that "procurement policy and procedures are well developed and adequately publicised."⁶⁵ The Government Advertising Agency operates government tenders which are advertised on the Israeli Government Tenders website, in Hebrew only.⁶⁶ The MoF website posts a list of tenders in English.

The Civil Service Commission is responsible for government employment. The commission operates open tenders for jobs in the civil service. However, at higher levels, ministers' personal advisors such as director generals, spokespeople and political assistants are still not subject to competitive recruitment procedures.

Of particular concern in 2002 were the attempts by politicians to undermine regulations that limit the appointment of members of party central committees to the boards of directors of government corporations. Under these regulations, which are supervised by a special, independent committee, members of party central committees must prove that they are more qualified than any other candidate before being appointed as a government company director. Criteria

for civil service positions in 2003 continued to be circumvented. For example, scandals erupted in which appointees were found to have essentially purchased college degrees.

A pilot project was announced in September by the Accountant General's office at the MoF for an online tender system within the larger framework of the E-Government Project. The online tender system is a trading platform for online government tenders.⁶⁷ It is hoped that the system will increase the transparency of the tender process. It is being launched as a joint venture between several government ministries and the Accountant General's office. The new system was put in place at the end of 2004 to supersede that being used in the pilot project. It is planned that the new system will serve as the infrastructure for a government procurement and tender platform to be used in coming years.⁶⁸

As noted by the IMF in a recent ROSC, “the tax and customs administrations are given adequate legal protection from political interference”.⁶⁹

Fiscal reporting

The Basic Law on the State Economy and the FBL stipulate the criteria for fiscal reporting. These cover such processes as budget preparation and the budget proposal.

The DAG prepares regular financial statements of the government accounts and reports to the Knesset and State Comptroller on all budgetary operations. The Accountant General reports on mid-year budget execution to the Knesset.⁷⁰

The Knesset Finance Committee is mandated to examine the budget prior to its passage into law. However, the committee has largely failed in its task as overseer of MoF activities and tends to be more politically minded. It lacks its own independent body of experienced investigative experts. It has tended to accept MoF forecasts based on previous budgets, rather than conducting independent assessments of past performance. Moreover, most committee members have demonstrated consistently that their primary concern is continued or expanded funding for their sectoral interests, even at the cost of more important macroeconomic concerns. Nonetheless, in their search for monies to spend, they occasionally stumble upon areas of MoF opacity.

The backroom dealings of the Finance Committee create another layer of opacity. When spending is examined by subject, rather than by institutional structure, the results can lead to considerable confusion. For example, spending on ultra-orthodox religious institutions is funnelled through no less than four ministries and is distributed into dozens of budgetary subsections. There was a precedent-setting decision by the Supreme Court in 2002 that has alleviated some of the opacity. The Court decided that henceforth there could be no more ‘double-budgeting’. In other words, the same institution can no longer receive financial assistance from two different ministries for the same purpose. This rule is being observed.

In theory, the Central Bureau of Statistics (CBS) operates a computer programme and facilities to analyse spending by subject. However, these tools have rarely been used. The computer programme was used when a yearly audit of subsidies and payments to settlers was required under the terms of US loan guarantees in the 1990s, and has been used to analyse other subject areas, such as health care and education. It has not been used for other important but politically sensitive issues, and some members of the Knesset may not be aware that the CBS even has this capability.

There is no in-year monthly report of expenditure broken down by composition.⁷¹ A 2004 IMF ROSC recommends the preparation and publication of a more detailed spending plan with medium-term expenditure targets, possibly

supplementing them with “semi-annual detailed reports on progress in achieving the government’s public finance goals and the implementation of the various measures and reforms.”⁷²

Revenue projections are compared to outcomes, and this is made publicly available.⁷³

4. ACCOUNTABILITY AND ASSURANCES OF INTEGRITY



Compliance in progress

Data quality standards

The Central Bureau of Statistics (CBS) collates and publishes all statistical information in Israel. The bureau meets the IMF SDDS for data quality. Effective tools and procedures are in place to assure the reconciliation and internal consistency of fiscal data. Budgetary projections have been less reliable in the last five years than they could have been, though revenue projections were more reasonable in the 2004 budget.

Independent scrutiny of fiscal information

Independent Audit

The State Comptroller's Office performs external audits on central and general government activities. The State Comptroller is independent of the executive branch. The office has access to all necessary information when carrying out its functions. The office's audits are based on timely and comprehensive information. It releases two reports per year, one that examines defence and security issues and the other government operations. The State Comptroller's Office also acts as the state's ombudsman. The State Comptroller's annual reports on the execution of the state budget and on the state balance sheet are available in a timely manner in hard copy and on the State Comptroller's website.⁷⁴ Mechanisms are in place to ensure that audited agencies take appropriate action to address the State Comptroller's recommendations.⁷⁵

The DAG has financial oversight over all ministries. Its Internal Audit Unit (IAU) is responsible for the internal audit of the execution of the state budget in all ministries' accounting and finance units. The IAU audits large government entities every two years and smaller ones every four years.

As noted by the IMF in a recent ROSC, "by 2007 all ministries and public entities will start publishing annual financial statements, including audited accounts and directors' statements". These will be consolidated into one government financial statement.⁷⁶ In addition to the annual reports already published, there are now 'special reports', published on specific matters from time to time.⁷⁷

National Statistics Agency

The CBS follows UN and other codes for national statistics bodies and is viewed as an independent institution.⁷⁸ The head of the CBS is proposed by the prime minister and appointed by the government. The CBS's library is open for public use.

INTERVIEWS

Representatives of *Oxford Analytica* interviewed the following officials during a visit to Israel between 1 and 4 November 2005:

Ministry of Finance

1 November 2005

Israel Kaplan	Senior Director
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3 November 2005

Dr Michael Sarel	Head	Economics and Research Department
Yossi Gordon	Deputy Director	Budget Department
Ron Alroy	Chief Accountant	Accountant General's Office
Avisar Cohen	Senior Deputy Accountant General	Accountant General's Office

Bank of Israel

2 November 2005

Eyal Argov	Monetary Dept.	Bank of Israel
Dr Ohad Bar-Efrat	Head	International Affairs
Yehudit Golan	Advisor	International Affairs

3 November 2005

Adi Brender	Senior Economist	Public Sector Analysis, Research Department
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ADDITIONAL INTERVIEWS

4 November 2005

Michal Frank	Assistant to the Director General	Israel Government Companies Authority
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3 November 2005

Soli Peleg	Senior Director	Macroeconomics Department Central Bureau of Statistics (CBS)
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NOTES

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- ¹ Ministry of Finance website, 'International Division, Functions of the Ministry and Structures of the Ministry' at: www.mof.gov.il
- ² Interviews in Israel, 1-4 November 2005.
- ³ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴ Interviews in Israel, 11-13 November 2002.
- ⁵ Interviews in Israel, 1-4 November 2005.
- ⁶ Interviews in Israel, 1-4 November 2005.
- ⁷ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁸ Bank of Israel website, 'Bank of Israel: Banker of the Government and Banks', at: www.bankisrael.gov.il.
- ⁹ Interviews in Israel, 1-4 November 2005.
- ¹⁰ Bank of Israel website, see end of month balance sheets on 'Information and Data' page, at: www.bankisrael.gov.il.
- ¹¹ Interviews in Israel, 1-4 November 2005.
- ¹² IMF 'Israel: Report on the Observance of Standards and Codes', March 2003.
- ¹³ Interviews in Israel, 1-4 November 2005.
- ¹⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ¹⁵ Interviews in Israel, 11-14 October 2004 and 1-4 November 2005.
- ¹⁶ Interviews in Israel, 1-4 November 2005.
- ¹⁷ Ministry of Foreign Affairs website, 'The Basic Law on Government', at: www.mfa.gov.il.
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- ¹⁹ Ministry of Finance - International Division, 'Functions of the Ministry' and 'Structures of the Ministry' at: www.mof.gov.il
- ²⁰ Ministry of Foreign Affairs website, 'The Basic Law on the State Economy', at: www.mfa.gov.il
- ²¹ 'Government Gateway: Information and Services' at: www.info.gov.il
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- ²⁶ Interviews in Israel, 1-4 November 2005.
- ²⁷ Central Bureau of Statistics, Selected Data (English) at: www.cbs.gov.il
- ²⁸ Interviews in Israel, 11-13 November 2002.
- ²⁹ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁰ Interviews in Israel, 1-4 November 2005.
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- ³² Interviews in Israel, 11-14 October 2004.
- ³³ Interviews in Israel, 1-4 November 2005.
- ³⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁵ Interviews in Israel, 1-4 November 2005.
- ³⁶ Interviews in Israel, 1-4 November 2005.
- ³⁷ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁸ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ³⁹ IMF 'Israel: Central government debt,' SDDS website at: dsbb.imf.org
- ⁴⁰ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴¹ Israel: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, June 2004.
- ⁴² IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁴³ Interviews in Israel, 27-29 October 2003.
- ⁴⁴ Interviews in Israel, 11-13 November 2002.
- ⁴⁵ Interviews in Israel, 1-4 November 2005.
- ⁴⁶ Oxford Analytica Daily Brief, 'Israel: Peretz, Sharon create political realignment', 21 November 2005.
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- ⁵⁰ Interviews in Israel, 1-4 November 2005.
- ⁵¹ Interviews in Israel, 29 October 2001.
- ⁵² Interviews in Israel, 27-29 October 2003 and 11-14 October 2004.
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- ⁵⁵ Interviews in Israel, 11-14 October 2004.
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- ⁶⁰ Interviews in Israel, 1-4 November 2005.
- ⁶¹ Interviews in Israel, 27-29 October 2003 and 11-14 November 2004.
- ⁶² Interviews in Israel, 1-4 November 2005.
- ⁶³ Interviews in Israel, 1-4 November 2005.
- ⁶⁴ Interviews in Israel, 1-4 November 2005.
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- ⁶⁶ See: michrazim.lapam.gov.il
- ⁶⁷ See: www.tenders.gov.il
- ⁶⁸ Press release, Ministry of Finance, 13 September 2004.
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- ⁷² Israel: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion, June 2004.
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- ⁷⁴ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004. See also: www.mevaker.gov.il
- ⁷⁵ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁷⁶ IMF 'Israel: Report on Observance of Standards and Codes – Fiscal Transparency Module', April 2004.
- ⁷⁷ Interviews in Israel, 1-4 November 2005.
- ⁷⁸ Interviews in Israel, 29 October 2001.